Second Quarter 2022

Management's Discussion and Analysis of Results of Operations and Financial Condition

August 2, 2022

AIR CANADA

A STAR ALLIANCE MEMBER

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1. SELECTED FINANCIAL METRICS AND STATISTICS

The financial and operating highlights for Air Canada for the periods indicated are as follows:

(Canadian dollars in millions, except per share data or where indicated)	Second Quarter			First Six Months		
Financial Performance Metrics	**2022**	**2021**	**$ Change**	**2022**	**2021**	**$ Change**
Operating revenues	3,981	837	3,144	6,554	1,566	4,988
Operating loss	(253)	(1,133)	880	(803)	(2,182)	1,379
Loss before income taxes	(352)	(1,298)	946	(1,166)	(2,685)	1,519
Net loss	(386)	(1,165)	779	(1,360)	(2,469)	1,109
Adjusted pre-tax loss (1)	(447)	(1,210)	763	(1,187)	(2,545)	1,358
Operating margin (%)	(6)	(135)	129 pp (8)	(12)	(139)	127 pp
EBITDA (excluding special items) (1)	154	(656)	810	11	(1,419)	1,430
EBITDA margin (1) (%)	4	(78)	82 pp	-	(91)	91 pp
Unrestricted liquidity (2)	10,508	9,775	733	10,508	9,775	733
Net cash flows from (used in) operating activities	1,077	(1,377)	2,454	1,412	(2,265)	3,677
Free cash flow (1)	441	(1,638)	2,079	500	(2,800)	3,300
Net debt (1)	7,028	7,085	(57)	7,028	7,085	(57)
Diluted loss per share	(1.60)	(3.31)	1.71	(3.80)	(7.19)	3.39
Operating Statistics (3)	**2022**	**2021**	**Change %**	**2022**	**2021**	**Change %**
Revenue passenger miles ("RPMs") (millions)	16,371	1,687	870.2	25,852	3,518	634.8
Available seat miles ("ASMs") (millions)	20,331	4,000	408.3	34,628	8,211	321.7
Passenger load factor %	80.5%	42.2%	38.3 pp	74.7%	42.8%	31.8 pp
Passenger revenue per RPM ("Yield") (cents)	21.0	25.3	(16.8)	20.7	23.3	(11.2)
Passenger revenue per ASM ("PRASM") (cents)	16.9	10.7	58.8	15.5	10.0	54.8
Operating revenue per ASM (cents)	19.6	20.9	(6.5)	18.9	19.1	(0.8)
Operating expense per ASM ("CASM") (cents)	20.8	49.3	(57.7)	21.2	45.7	(53.5)
Adjusted CASM (cents) (1)	13.1	41.5	(68.4)	14.1	40.9	(65.5)
Average number of full-time-equivalent ("FTE") employees (thousands) (4)	29.5	16.5	78.7	28.4	16.3	74.1
Aircraft in operating fleet at period-end (5)	342	336	1.8	342	336	1.8
Seats dispatched (thousands)	11,744	2,668	340.2	20,397	5,239	289.3
Aircraft frequencies (thousands)	86.0	24.3	253.8	151.0	46.4	225.2
Average stage length (miles) (6)	1,731	1,505	15.1	1,698	1,570	8.1
Fuel cost per litre (cents)	147.3	68.3	115.7	126.1	65.6	92.1
Fuel litres (thousands)	983,688	349,690	181.3	1,744,550	668,048	161.1
Revenue passengers carried (thousands) (7)	9,145	1,165	685.0	14,580	2,289	537.0

(1) Adjusted pre-tax loss, EBITDA (excluding special items) (earnings before interest, taxes, depreciation, and amortization), EBITDA margin, free cash flow, net debt and adjusted CASM are non-GAAP financial measures, non-GAAP ratios or supplemental financial measures. Such measures are not recognized measures for financial statement presentation under GAAP, do not have standardized meanings, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for descriptions of Air Canada's non-GAAP financial measures and for a quantitative reconciliation of Air Canada's non-GAAP financial measures to the most comparable GAAP measure.

(2) Unrestricted liquidity refers to the sum of cash, cash equivalents, short and long-term investments, and the amounts available under Air Canada's credit facilities. Unrestricted liquidity, as at June 30, 2022, consisted of $9,536 million in cash, cash equivalents, short and long-term investments and $972 million available under undrawn credit facilities. As at June 30, 2021, unrestricted liquidity consisted of $5,661 million in cash, cash equivalents, short and long-term investments and $3,975 million available under undrawn credit facilities with the Government of Canada and $139 million available to be drawn under the Government of Canada refunds credit facility.

(3) Except for the reference to average number of FTE employees, operating statistics in this table include third party carriers operating under capacity purchase agreements with Air Canada.

(4) Reflects FTE employees at Air Canada and its subsidiaries. Excludes FTE employees at third party carriers operating under capacity purchase agreements with Air Canada. As of June 30, 2022, there were 30,204 employees based in Canada.

(5) The number of aircraft in Air Canada's operating fleet at June 30, 2022 and at June 30, 2021 include aircraft that were grounded due to the impact of the COVID-19 pandemic.

(6) Average stage length is calculated by dividing the total number of available seat miles by the total number of seats dispatched.

(7) Revenue passengers are counted on a flight number basis (rather than by journey/itinerary or by leg) which is consistent with the IATA definition of revenue passengers carried.

(8) "pp" denotes percentage points and refers to a measure of the arithmetic difference between two percentages.

2. INTRODUCTION AND KEY ASSUMPTIONS

In this Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the "Corporation" refers, as the context may require, to Air Canada and/or one or more of Air Canada's subsidiaries, including its wholly owned operating subsidiaries, Aeroplan Inc. ("Aeroplan"), Touram Limited Partnership, doing business under the brand name Air Canada Vacations® ("Air Canada Vacations"), and Air Canada Rouge LP, doing business under the brand name Air Canada Rouge® ("Air Canada Rouge"). This MD&A provides the reader with a review and analysis, from the perspective of management, of Air Canada's financial results for the second quarter of 2022. This MD&A should be read in conjunction with Air Canada's interim unaudited condensed consolidated financial statements and notes for the second quarter of 2022 dated August 2, 2022, as well as Air Canada's 2021 annual audited consolidated financial statements and notes and Air Canada's 2021 MD&A each dated February 18, 2022. All financial information has been prepared in accordance with generally accepted accounting principles in Canada ("GAAP"), as set out in the CPA Canada Handbook – Accounting ("CPA Handbook"), which incorporates International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), except for any non-GAAP measures and any financial information specifically denoted otherwise.

Except as otherwise noted, monetary amounts are stated in Canadian dollars. For an explanation of certain terms used in this MD&A, refer to section 17 "Glossary" of this MD&A. Except as otherwise noted or where the context may otherwise require, this MD&A is current as of August 1, 2022.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of risks relating to Air Canada, refer to section 18 "Risk Factors" of Air Canada's 2021 MD&A and section 14 "Risk Factors" of this MD&A. Air Canada issued a news release dated August 2, 2022 reporting on its results for the second quarter 2022. This news release is available on Air Canada's website at **aircanada.com** and on SEDAR's website at **www.sedar.com**. For further information on Air Canada's public disclosures, including Air Canada's Annual Information Form, consult SEDAR at **www.sedar.com**.

Caution Regarding Forward-Looking Information

Air Canada's public communications may include forward-looking statements within the meaning of applicable securities laws. Forward-looking statements relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to guidance, strategies, expectations, planned operations or future actions. Forward-looking statements are identified using terms and phrases such as "preliminary", "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions.

Forward-looking statements, by their nature, are based on assumptions including those described herein and the documents incorporated by reference herein and are subject to important risks and uncertainties. Forward-looking statements cannot be relied upon due to, among other things, changing external events and general uncertainties of the business of Air Canada. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including those discussed below.

Since March 2020, Air Canada and the rest of the global airline industry have faced significantly lower traffic than in 2019, and a corresponding decline in revenue and cash flows, as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world including in Canada. Conditions have improved and travel restrictions have been lifted in many countries, but the wide-ranging impact of the COVID-19 pandemic and certain other factors have impeded Air Canada's and the global airline industry's restart efforts. It has also affected the ability of some of its participants, on which Air Canada's operations are dependent, to support the surge in traffic. This has led to flight delays and cancellations, and other operational disruptions and challenges. Air Canada cannot predict the timing for when such challenges may be overcome or the timing and extent of the return to pre-pandemic traffic levels. The return of business travel to pre-pandemic levels may be challenged by the evolving nature of business models and remote-work practices adopted during the COVID-19 pandemic, such as the use of videoconferencing and other remote-work technologies, as well as by interest in more sustainable practices. Air Canada is actively monitoring key indicators relevant to its rebuilding plans and will adjust as required. This will include the evolving impact of the pandemic, the timing and extent of recovery in the international and business travel segments, the ability of industry participants to overcome challenges in restarting the industry and meeting the surge in traffic, economic and other factors, none of which can be predicted with certainty.

Other factors that may cause results to differ materially from results indicated in forward-looking statements include economic and geopolitical conditions such as the military conflict between Russia and Ukraine, Air Canada's ability to successfully achieve or sustain positive net profitability, industry and market conditions and the demand environment, Air Canada's ability to pay its indebtedness and maintain or increase liquidity, competition, Air Canada's dependence on technology, cybersecurity risks, energy prices, Air Canada's ability to successfully implement appropriate strategic and other important initiatives (including Air Canada's ability to manage operating costs), other epidemic diseases, terrorist acts, war, Air Canada's dependence on key suppliers (including government agencies and other stakeholders supporting airport and airline operations), Air Canada's ability to successfully operate its loyalty program, interruptions of service, Air Canada's ability to attract and retain required personnel, the availability and onboarding of Air Canada's workforce, casualty losses, changes in laws, regulatory developments or proceedings, climate change and environmental factors (including weather systems and other natural phenomena and factors arising from anthropogenic sources), Air Canada's dependence on regional and other carriers, Air Canada's ability to preserve and grow its brand, employee and labour relations and costs, Air Canada's dependence on Star Alliance® and joint ventures, pending and future litigation and actions by third parties, currency exchange, limitations due to restrictive covenants, insurance issues and costs, pension plans, as well as the factors identified in Air Canada's public disclosure file available at **www.sedar.com** and, in particular, those identified in section 18 "Risk Factors" in Air Canada's 2021 MD&A and section 14 "Risk Factors" of this MD&A. The forward-looking statements contained or incorporated by reference in this MD&A represent Air Canada's expectations as of the date of this MD&A (or as of the date they are otherwise stated to be made) and are subject to change after such date. However, Air Canada disclaims any intention or obligation to update or revise any forward-looking statements whether because of new information, future events or otherwise, except as required under applicable securities regulations.

Key Assumptions

Assumptions were made by Air Canada in preparing and making forward-looking statements. As part of its assumptions, Air Canada assumes moderate Canadian GDP growth for 2022. Air Canada now assumes that the Canadian dollar will trade, on average, at C$1.28 per U.S. dollar in 2022 and that the price of jet fuel will average $1.27 per litre in 2022.

Intellectual Property

Air Canada owns or has rights to trademarks, service marks or trade names used in connection with the operation of its business. In addition, Air Canada's names, logos and website names and addresses are owned or licensed by Air Canada. Air Canada also owns or has the rights to copyrights that also protect the content of its products and/or services. Solely for convenience, the trademarks, service marks, trade names and copyrights referred to in this MD&A may be listed without the ©, ® and ™ symbols, but Air Canada reserves all rights to assert, to the fullest extent under applicable law, its rights, or the rights of the applicable licensors to these trademarks, service marks, trade names and copyrights. This MD&A may also include trademarks, service marks or trade names of other parties. Air Canada's use or display of other parties' trademarks, service marks, trade names or products is not intended to, and does not imply a relationship with, or endorsement or sponsorship of Air Canada by, the trademark, service mark or trade name owners or licensees.

Incorporation of Other Information

No information contained on or accessed via Air Canada's websites (or any other website referred to in this MD&A), and no document referred to in this MD&A, is incorporated into or forms part of this MD&A, except if it is expressly stated in this MD&A to be incorporated into this MD&A.

3. STRATEGY

Air Canada is evolving its business to better prepare for the future. As part of these efforts, Air Canada has introduced "Rise Higher", its newly articulated business imperatives, intended to elevate every aspect of its business. As it embarks on this next chapter, Air Canada will:

- Fund its future by staying vigilant on costs, seizing on opportunities, and making the right strategic investments
- Reach new frontiers, by embracing its competitive strengths to grow the business by expanding its international reach, and continually exploring new opportunities
- Elevate its customers, and support the creation of meaningful customer experiences and human connections by leveraging innovations in technology, loyalty and products
- Foster a collaborative workplace that respects diverse cultures and languages, while making impactful contributions to society

In pursuit of this goal, in 2022, Air Canada will build upon and leverage its numerous competitive advantages, including:

- Its talented people, and award-winning culture
- A widely recognized and powerful brand
- A streamlined, modern, fuel efficient and versatile fleet, with market-leading aircraft configurations
- A global network, well positioned to meet demand from various customer segments, and enhanced by the airline's membership in Star Alliance and by numerous commercial arrangements
- A customer experience enhanced by competitive products and services, including the fully transformed Aeroplan program
- Air Canada Rouge, a lower-cost leisure carrier
- A growing cargo offering
- New core technologies and other technological improvements
- Its commitment to sustainability

Additional information on Air Canada's strategy can be found in section 5 "Strategy" of Air Canada's 2021 MD&A.

4. OVERVIEW & SECOND QUARTER 2022 HIGHLIGHTS

Second Quarter 2022 Financial Summary

The following is an overview of Air Canada's results of operations and financial position for the second quarter 2022 compared to the second quarter 2021, with selected comparisons to the second quarter 2019, being the pre-pandemic comparison period.

- Operating revenues of $3,981 million compared to second quarter operating revenues of $837 million in 2021, a nearly five-fold increase of $3,144 million. Compared to pre-pandemic levels, operating revenues recovered to about 84% of those in the second quarter of 2019.

- Operating expenses of $4,234 million versus operating expenses of $1,970 million in the second quarter of 2021, an increase of $2,264 million or 115% on an operated capacity of about five times that of the same period in 2021, which included a 116% increase in fuel price.

- Operating loss of $253 million decreased $880 million from the second quarter of 2021.

- EBITDA (excluding special items) of $154 million improved $810 million from the second quarter of 2021.

- Net cash flows from operating activities of $1,077 million versus net cash used in operating activities of $1,377 million in the second quarter of 2021. The increase was driven by better operating results and strong advance ticket sales in the second quarter of 2022, and reflects the refund of eligible non-refundable tickets, which amounted to $997 million in the second quarter of 2021. Refer to section 7.5 "Cash Flow Movements" of this MD&A for additional information.

Easing of Travel Restrictions

During the second quarter of 2022, there was a further easing of travel restrictions by the Government of Canada. These changes included:

- Since April 1, 2022, fully vaccinated travellers are no longer required to provide a negative pre-entry COVID-19 test result.

- Randomized testing for fully vaccinated travellers was temporarily suspended as of June 11, 2022 but resumed on July 19, 2022 (including for unvaccinated and for randomly selected fully vaccinated travellers) though it is now performed offsite.

- Since June 20, 2022, passengers are no longer required to present a proof of vaccination for boarding an aircraft in Canada. The requirements for passengers entering Canada remain unchanged.

Foreign nationals must qualify as fully vaccinated to enter Canada unless they meet an exemption set out in the Orders made under the *Quarantine Act*. Generally, unvaccinated or partially vaccinated travellers allowed to enter Canada remain subject to the federal requirement to quarantine and must take a test prior to arrival, at the time of arrival, and on day eight after arrival.

Route Network and Schedule

The impact of the COVID-19 pandemic and certain other factors have impeded Air Canada's and the global airline industry's restart efforts and the ability of some of its participants, on which Air Canada's operations are dependent, to support the surge in traffic, which has led to flight delays and cancellations, and other operational disruptions and challenges. As a result, in late June 2022, Air Canada decided to proactively cancel about 8% of its scheduled flights in July and August 2022. This reduction represented about 154 fewer flights per day, on average, mostly achieved through frequency reductions on domestic and U.S. transborder routes to and from Toronto and Montreal, leaving international flights unaffected, or a total of about 378 million ASMs.

5. RESULTS OF OPERATIONS

The table and discussion below provide and compare results of Air Canada for the periods indicated.

(Canadian dollars in millions, except where indicated)	Second Quarter				First Six Months			
	2022	2021	$ Change	% Change	2022	2021	$ Change	% Change
Operating revenues								
Passenger	$ 3,441	$ 426	$ 3,015	708	$ 5,358	$ 821	$ 4,537	553
Cargo	299	358	(59)	(16)	697	639	58	9
Other	241	53	188	355	499	106	393	371
Total operating revenues	**3,981**	**837**	**3,144**	**376**	**6,554**	**1,566**	**4,988**	**319**
Operating expenses								
Aircraft fuel	1,450	239	1,211	507	2,200	439	1,761	401
Wages, salaries, and benefits	749	497	252	51	1,456	1,025	431	42
Regional airlines expense, excluding fuel	367	193	174	90	683	388	295	76
Depreciation and amortization	407	404	3	1	810	817	(7)	(1)
Aircraft maintenance	195	127	68	54	221	277	(56)	(20)
Airport and navigation fees	241	109	132	121	424	207	217	105
Sales and distribution costs	171	44	127	289	279	68	211	310
Ground package costs	102	1	101	N.M. (1)	231	6	225	N.M.
Catering and onboard services	94	21	73	348	158	42	116	276
Communications and information technology	103	81	22	27	219	186	33	18
Special items	-	73	(73)	(100)	4	(54)	58	(107)
Other	355	181	174	96	672	347	325	94
Total operating expenses	**4,234**	**1,970**	**2,264**	**115**	**7,357**	**3,748**	**3,609**	**96**
Operating loss	**(253)**	**(1,133)**	**880**		**(803)**	**(2,182)**	**1,379**	
Non-operating income (expense)								
Foreign exchange gain (loss)	(196)	(5)	(191)		(97)	62	(159)	
Interest income	31	16	15		51	37	14	
Interest expense	(216)	(164)	(52)		(425)	(341)	(84)	
Interest capitalized	2	5	(3)		5	9	(4)	
Net interest relating to employee benefits	4	(5)	9		8	(9)	17	
Gain (loss) on financial instruments recorded at fair value	287	(5)	292		114	(228)	342	
Loss on debt settlements and modifications	-	-	-		-	(19)	19	
Other	(11)	(7)	(4)		(19)	(14)	(5)	
Total non-operating expense	**(99)**	**(165)**	**66**		**(363)**	**(503)**	**140**	
Loss before income taxes	**(352)**	**(1,298)**	**946**		**(1,166)**	**(2,685)**	**1,519**	
Income tax recovery (expense)	(34)	133	(167)		(194)	216	(410)	
Net loss	**$ (386)**	**$ (1,165)**	**$ 779**		**$ (1,360)**	**$ (2,469)**	**$ 1,109**	
Diluted loss per share	**$ (1.60)**	**$ (3.31)**	**$ 1.71**		**$ (3.80)**	**$ (7.19)**	**$ 3.39**	
EBITDA (excluding special items) (2)	**$ 154**	**$ (656)**	**$ 810**		**$ 11**	**$ (1,419)**	**$ 1,430**	
Adjusted pre-tax loss (2)	**$ (447)**	**$ (1,210)**	**$ 763**		**$ (1,187)**	**$ (2,545)**	**$ 1,358**	

(1) N.M. denotes "not meaningful"

(2) EBITDA (excluding special items) and adjusted pre-tax loss are non-GAAP financial measures. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

System Passenger Revenues

In the second quarter of 2022, passenger revenues of $3,441 million increased $3,015 million or about eight times from the second quarter of 2021. Total operated capacity increased about five times, while traffic increased almost 10 times, resulting in a 38-percentage-point increase in passenger load factor year-over-year. As a result of COVID-19 pandemic-related travel restrictions in place at that time, travel demand in the first half of 2021 was primarily for essential purposes, booked close to departure date and on shorter stage-length journeys than prior to the pandemic as a result of the COVID-19 pandemic-related travel restrictions in place at that time. The demand environment, primarily in the first six months of 2021, favoured higher yields with low passenger load factors, as such, certain comparisons versus 2021 may not be meaningful. Air Canada believes that a comparison to the second quarter of 2019 allows for a better understanding of passenger revenues and the development of Air Canada's recovery.

Second quarter 2022 passenger revenues reached 80% of those in the second quarter of 2019, on a capacity that represented 73% of the same period in 2019. Compared to the second quarter of 2019, yield and PRASM increased 14% and 9%, respectively. The capacity operated in the second quarter of 2022, was in line with the projection provided in Air Canada's news release dated April 26, 2022.

In the second quarter of 2022, at the cabin level, passenger revenues increased about 10 times for business, 13 times for premium economy, and seven times for economy, when compared to the second quarter of 2021.

These results were driven by the strong recovery in demand for air travel following the further easing of travel restrictions in Canada and in many of the countries Air Canada operates to. Air Canada continued to restore its services on many U.S. and international destinations. The second quarter of 2022 closed strong, with June 2022 achieving the best monthly results since the start of the pandemic. June 2022 passenger revenues represented 87% of those in June 2019 driven by system yield and PRASM increasing 15% and 13%, respectively, from June 2019.

The table below provides passenger revenues by geographic region for the periods indicated.

(Canadian dollars in millions)	Second Quarter						
	2022	2021	$ Change	% Change	2019	$ Change	% Change
Canada	$ 1,115	$ 268	$ 847	316	$ 1,333	$ (218)	(16)
U.S. transborder	761	32	729	2,230	955	(194)	(20)
Atlantic	1,051	75	976	1,303	1,151	(100)	(9)
Pacific	226	35	191	560	621	(395)	(64)
Other	288	16	272	1,679	259	29	11
System	**$ 3,441**	**$ 426**	**$ 3,015**	**708**	**$ 4,319**	**$ (878)**	**(20)**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the periods indicated.

	Second Quarter 2022 versus Second Quarter 2021					
	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	316	186	391	34	(15)	45
U.S. transborder	2,230	1,386	3,039	42	(26)	57
Atlantic	1,303	490	1,157	43	12	138
Pacific	560	212	660	46	(13)	111
Other	1,679	1,880	2,431	18	(30)	(10)
System	**708**	**408**	**870**	**38**	**(17)**	**59**

	Second Quarter 2022 versus Second Quarter 2019					
	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	(16)	(14)	(17)	(2)	0	(3)
U.S. transborder	(20)	(21)	(24)	(3)	5	1
Atlantic	(9)	(12)	(16)	(4)	8	3
Pacific	(64)	(74)	(76)	(6)	51	41
Other	11	(11)	(15)	(4)	31	25
System	**(20)**	**(27)**	**(30)**	**(4)**	**14**	**9**

Domestic Passenger Revenues

In the second quarter of 2022, Domestic passenger revenues of $1,115 million increased $847 million from the second quarter of 2021. Capacity and traffic increased by about five and nine times, respectively, year over year, resulting in a passenger load factor increase of 34 percentage points. These results largely reflect the increased demand for air services and greater availability of routes and frequencies across our domestic network. As a result of the COVID-19 pandemic and travel restrictions in place at that time, travel demand in the first half of 2021 was primarily for essential purposes, booked close-in to departure date and on shorter stage-length journeys than prior to the pandemic. This non-comparable environment, in 2021, generated statistically high yields.

Domestic passenger revenues in the second quarter of 2022 were about 84% of those in the second quarter of 2019 on an operated capacity representing 86% of that in the same period of 2019. At the cabin level, PRASM increased 13% and 17% for Business and Premium Economy, respectively, and declined 7% for Economy, reflecting a change in traffic mix due to the increase in demand for premium services by leisure travellers and due to the impact of stage length in the Domestic market. Second quarter of 2022 average fares in the Domestic market increased 14% from the second quarter of 2019, this increase was offset by longer stage length compared to the second quarter of 2019. The increase in stage length had the impact of reducing yields by 8% in the second quarter of 2022 as compared to the second quarter of 2019. Average fares in June 2022 were up 16% from June 2019 levels reflecting the strength of the recovery in the Domestic marketplace and considering higher jet fuel prices.

In the first six months of 2022, Domestic passenger revenue of $1,763 million increased $1,258 million from the same period in 2021 largely attributable to the impact of the COVID-19 pandemic and the significant travel restrictions in the first six months of 2021 compared to the first six months of 2022.

U.S. Transborder Passenger Revenues

In the second quarter of 2022, U.S. transborder passenger revenues of $761 million increased $729 million from the second quarter of 2021. When compared to the second quarter of 2021, second quarter 2022 capacity and traffic grew about 15 and 31 times, respectively. In the first half of 2021, most of the U.S. routes were suspended due to the border closures. Travel demand in the first half of 2021 was primarily for essential purposes, booked close-in to departure date and on shorter stage-length journeys than pre-pandemic as a result of the COVID-19 pandemic and travel restrictions in place at that time. This non-comparable environment, in 2021, generated statistically high yields.

Second quarter 2022 U.S. transborder passenger revenues were 80% of those in the second quarter of 2019 on an operated capacity 79% of the second quarter 2019 capacity. Compared to the second quarter of 2019, better yields and PRASM in most U.S. transborder markets, due to better performance of our premium products, partially offset the traffic decline. U.S. transborder average fares in the second quarter of 2022 increased about 13% from the same period in 2019, also reflecting our ability to pass through some of the higher cost of fuel. The increase in U.S. transborder average stage length from the second quarter of 2019 had the impact of reducing yields by about 5%. Differences in the U.S. transborder network, compared to that of the second quarter of 2019, along with strong sixth freedom traffic originating in the USA were key areas of focus in the second quarter of 2022.

In the first six months of 2022, U.S. transborder passenger revenues of $1,186 million increased $1,125 million from the same period last year largely attributable to the impact of the COVID-19 pandemic and the significant travel restrictions in the first six months of 2021 compared to the first six months of 2022.

Atlantic Passenger Revenues

In the second quarter of 2022, Atlantic passenger revenues of $1,051 million increased $976 million from the second quarter of 2021. Compared to the second quarter of 2021, capacity, traffic, yield, and PRASM all improved meaningfully as a result of a more normalized operating environment following the easing of travel restrictions.

In the second quarter of 2022, Atlantic passenger revenues represented 91% of those in the second quarter of 2019 with yield and PRASM gains more than offsetting the capacity and the resulting traffic decline. In addition, June 2022 average fares increased 15% from June 2019 due to traffic mix changes in favour of premium products from leisure travellers and to fare increases in response to higher jet fuel prices.

In the first six months of 2022, Atlantic passenger revenues of $1,515 million increased $1,353 million from the same period last year largely attributable to the impact of the COVID-19 pandemic and the significant travel restrictions in the first six months of 2021 compared to the first six months of 2022.

Pacific Passenger Revenues

In the second quarter of 2022, Pacific passenger revenues of $226 million increased $191 million compared to the same quarter in 2021. These results are largely due to a slightly better operating environment in the Pacific market following the easing of certain travel restrictions (although limited) over the last few months.

When compared to the second quarter of 2019, Pacific passenger revenues declined 64% due the significantly reduced capacity in all Asian markets served, most notably China and Hong Kong, as a result of the travel restrictions that remained in place. The decline was partially offset by a yield increase of 51% and PRASM increase of 41%, as a result of increased demand with lower capacity available and changes in traffic mix. In the second quarter of 2022, Air Canada restarted certain routes to Japan and South Korea.

In the first six months of 2022, Pacific passenger revenues of $324 million increased $273 million from the same period last year reflecting the slightly better operating environment compared to the first half of 2021.

Other Passenger Revenues

In the second quarter of 2022, other passenger revenues of $288 million increased $272 million from the second quarter of 2021.

When compared to the second quarter of 2019, other passenger revenues increased 11% as a result of a 31% yield increase and a 25% PRASM increase, most notably in Central America and the Caribbean. The increase in revenues was partially offset by lower capacity and resulting lower traffic in the second quarter of 2022.

In the first six months of 2022, other passenger revenues of $570 million increased $528 million from the same period last year largely attributable to the impact of the COVID-19 pandemic and the significant travel restrictions in the first six months of 2021 compared to the first six months of 2022.

The table below provides passenger revenues by geographic region for the periods indicated.

(Canadian dollars in millions)	**First Six Months**						
	2022	**2021**	**$ Change**	**% Change**	**2019**	**$ Change**	**% Change**
Canada	$ 1,763	$ 505	$ 1,258	249	$ 2,430	$ (667)	(27)
U.S. transborder	1,186	61	1,125	1,832	1,897	(711)	(38)
Atlantic	1,515	162	1,353	836	1,913	(398)	(21)
Pacific	324	51	273	540	1,155	(831)	(72)
Other	570	42	528	1,249	721	(151)	(21)
System	**$ 5,358**	**$ 821**	**$ 4,537**	**553**	**$ 8,116**	**$ (2,758)**	**(34)**

The table below provides year-over-year percentage changes in passenger revenues and operating statistics for the periods indicated.

	First Six Months of 2022 versus First Six Months of 2021					
	Passenger Revenue % Change	**Capacity (ASMs) % Change**	**Traffic (RPMs) % Change**	**Passenger Load Factor pp Change**	**Yield % Change**	**PRASM % Change**
Canada	249	153	314	30	(16)	38
U.S. transborder	1,832	1,268	2,386	32	(22)	41
Atlantic	836	314	669	35	22	126
Pacific	540	176	570	43	(4)	132
Other	1,249	967	1,373	20	(8)	26
System	**553**	**322**	**635**	**32**	**(11)**	**55**

	First Six Months of 2022 versus First Six Months of 2019					
	Passenger Revenue % Change	Capacity (ASMs) % Change	Traffic (RPMs) % Change	Passenger Load Factor pp Change	Yield % Change	PRASM % Change
Canada	(27)	(22)	(28)	(6)	0	(7)
U.S. transborder	(38)	(33)	(42)	(11)	8	(6)
Atlantic	(21)	(20)	(26)	(6)	7	(1)
Pacific	(72)	(78)	(81)	(11)	50	30
Other	(21)	(24)	(36)	(13)	24	5
System	**(34)**	**(36)**	**(42)**	**(8)**	**14**	**3**

The table below provides, by market, Air Canada's revenue passenger miles (RPMs) and available seat miles (ASMs) for the periods indicated.

	Second Quarter				First Six Months			
	2022		2021		2022		2021	
(millions)	RPMs	ASMs	RPMs	ASMs	RPMs	ASMs	RPMs	ASMs
Canada	4,252	5,217	866	1,825	6,754	8,864	1,633	3,508
U.S. transborder	2,924	3,682	93	248	4,717	6,674	190	488
Atlantic	6,314	7,838	502	1,329	9,226	11,991	1,200	2,894
Pacific	1,218	1,544	160	494	1,788	2,444	266	885
Other	1,663	2,050	66	104	3,367	4,655	229	436
System	**16,371**	**20,331**	**1,687**	**4,000**	**25,852**	**34,628**	**3,518**	**8,211**

Cargo Revenues

In the second quarter of 2022, cargo revenues of $299 million declined $59 million or 16% from the second quarter of 2021. The decline was due to yield normalization and less cargo-only flying in the Pacific market. This was partially offset by revenue gains in other regions. The main contributors for the decline in Pacific flying were the COVID-related lockdowns in China, and to a lesser extent, Hong Kong and Japan. Although capacity was redeployed to other regions, higher revenues from Europe, Australia and the Americas did not compensate for the revenue lost primarily in China in terms of volume and yield.

In the first six months of 2022, cargo revenues of $697 million increased $58 million or 9% compared to the first six months of 2021. The increase was mainly a result of stronger yields compared to the same period last year, most notably in the Pacific and Other markets.

In the second quarter of 2022, Air Canada introduced it's second Boeing 767 freighter aircraft and also operated its last cargo-only flight using the temporarily converted passenger aircraft.

The table below provides cargo revenues by geographic region for the periods indicated.

(Canadian dollars in millions)	Second Quarter				First Six Months			
	2022	2021	$ Change	% Change	2022	2021	$ Change	% Change
Canada	$ 28	$ 25	$ 3	10	$ 58	$ 49	$ 9	18
U.S. transborder	10	17	(7)	(42)	23	28	(5)	(18)
Atlantic	146	144	2	1	270	263	7	3
Pacific	79	150	(71)	(47)	273	258	15	6
Other	36	22	14	67	73	41	32	78
System	**$ 299**	**$ 358**	**$ (59)**	**(16)**	**$ 697**	**$ 639**	**$ 58**	**9**

Other Revenues

In the second quarter of 2022, other revenues of $241 million increased $188 million or about four-and-a-half times from the second quarter of 2021 (other revenues of $499 million in the first six months of 2022 increased $393 million or close to five times from the first six months of 2021). The increases were primarily due to a higher volume of ground package revenues at Air Canada Vacations compared to the same periods in 2021, reflecting the increased demand for vacation packages and the impact of the suspension of flights to Mexico and the Caribbean between January 31, 2021 and June 26, 2021. To a lesser extent, higher on-board revenues and Maple Leaf Lounge revenues driven by the return of traffic and the re-introduction of these services in 2022 also contributed to the increases.

Operating Expenses

In the second quarter of 2022, total operating expenses of $4,234 million increased $2,264 million or 115% from the second quarter of 2021. The variance is explained by increases in all line items, except for special items, largely reflecting the year-over-year growth in traffic and operated capacity. In addition, the 116% increase in fuel cost significantly contributed to the variance.

In the first six months of 2022, total operating expenses of $7,357 million increased $3,609 million or 96% from the same period in 2021. The variance is explained by increases in nearly all line items largely reflecting the year-over-year growth in traffic and operated capacity, most notably the increase in fuel cost.

The more notable year-over-year variances in operating expenses in the second quarter of 2022 and in the first six months compared to the same periods in 2021 are summarized below.

<u>Aircraft Fuel</u>

In the second quarter of 2022, fuel expense of $1,450 million increased $1,211 million or about six times from the second quarter of 2021. The increase was the result of jet fuel prices more than doubling year-over-year, as well as a result of the higher volume of flying compared to the second quarter of 2021. To a lesser extent, an unfavourable foreign exchange variance also contributed to the year-over-year increase.

In the first six months of 2022, fuel expense of $2,200 million increased $1,761 million or about five times from the same period of 2021 as a result of a 92% increase in jet fuel price as well as a result of the higher volume of flying compared to the same period in 2021.

<u>Wages, Salaries and Benefits</u>

In the second quarter of 2022, wages, salaries, and benefits of $749 million increased $252 million or 51% from the second quarter of 2021. The variance was mainly due to a 79% increase in FTEs compared to the same period in 2021 as Air Canada significantly increased its staffing levels to support the increase in flying volume year-over-year, including in preparation for a continued ramp-up of activity levels for the remainder of the year.

In the first six months of 2022, wages, salaries, and benefits of $1,456 million increased $431 million or 42% from the first six months of 2021. The variance was mainly due to the 74% increase in FTEs compared to the same period in 2021 as Air Canada significantly increased its staffing levels to support the increase in flying volume year-over-year.

Regional Airlines Expense

In the second quarter of 2022, regional airlines expense (excluding fuel and ownership costs) of $367 million increased $174 million or 90% from the second quarter of 2021. The increase was due to a higher volume of flying compared to the second quarter of 2021.

In the first six months of 2022, regional airlines expense (excluding fuel and ownership costs) of $683 million increased $295 million or 76% from the first six months of 2021. The increase was due to a higher volume of flying compared to the first quarter of 2021 and was partially offset by savings from the consolidation of regional flying under the renegotiated CPA with Jazz.

The following table provides a breakdown of regional airlines expense for the periods indicated.

	Second Quarter				First Six Months			
(Canadian dollars in millions)	**2022**	**2021**	**$ Change**	**% Change**	**2022**	**2021**	**$ Change**	**% Change**
Capacity purchase fees [(1)]	$ 188	$ 112	$ 76	68	$ 355	$ 227	$ 128	56
Airport and navigation	58	22	36	164	103	41	62	151
Sales and distribution costs	26	4	22	550	40	9	31	344
Other operating expenses	95	55	40	73	185	111	74	67
Total regional airlines expense	**$ 367**	**$ 193**	**$ 174**	**90**	**$ 683**	**$ 388**	**$ 295**	**76**

(1) Capacity purchase fees exclude the component of fees related to aircraft ownership costs which are accounted for as lease liabilities in accordance with IFRS 16 – Leases.

Aircraft Maintenance

In the second quarter of 2022, aircraft maintenance expense of $195 million increased $68 million or 54% from the second quarter of 2021. The increase was largely due to higher maintenance activity due to higher volume of flying compared to the same period in 2021. Savings resulting from an amended agreement with a third-party maintenance provider, as further described below, partially offset the year-over-year increase.

In the first six months of 2022, aircraft maintenance expense of $221 million decreased $56 million or 20% from the first six months of 2021. In the first quarter of 2022, Air Canada and a third-party maintenance provider completed an amended agreement. In connection with this, a favourable adjustment of $159 million was recorded in Aircraft maintenance expense arising from the adjustment to maintenance accruals and recognition of future credits that will be available under the amended agreement. Given the significantly reduced aircraft operations and fleet reductions during the COVID-19 pandemic, this agreement was amended by the parties to convert the nature of the services from a power-by-the-hour basis to a time and materials contract and reduced the number of items covered under the agreement. The expense reduction was partially offset by increased volume of maintenance activity resulting from the increased flying year-over-year and by an increase in maintenance provisions reflecting updated end-of-lease cost estimates in anticipation of returning aircraft to lessors upon lease expiries over the next 12 months.

Ground package costs

In the second quarter of 2022 and in the first six months of 2022, ground package costs of $102 million and of $231 million increased $101 million and $225 million from the same period in 2021, respectively. The increases are largely due to a higher volume of ground package revenues at Air Canada Vacations year-over-year for the respective periods. Air Canada suspended its flights to Mexico and Caribbean destinations between January 31, 2021 and June 26, 2021.

Special Items

In the second quarter of 2022, Air Canada did not record special items compared to a net operating expense of $73 million recorded as special items in the second quarter of 2021. The table below provides the breakdown of these special items.

	Second Quarter		First Six Months	
(Canadian dollars in millions)	**2022**	**2021**	**2022**	**2021**
Impairments	$ -	$ 6	$ 4	$ 26
Government wage subsidy, net	-	(158)	-	(321)
Workforce reduction provisions	-	157	-	159
Benefit plan amendments	-	68	-	68
Other	-	-	-	14
Special Items	**$ -**	**$ 73**	**$ 4**	**$ (54)**

Impairments

In the first six months of 2021, an impairment charge of $26 million was recorded as a result of reductions to the estimates around the expected disposal proceeds on owned aircraft, partially offset by lower-than-expected costs to meet contractual return conditions on lease returns. An impairment charge of $4 million was recorded in the first six months of 2022 related to the return of leased aircraft. Further changes to these estimates may result in additional adjustments to the impairment charge in future periods.

Government Wage Subsidy

No wage subsidy was recorded in the first six months of 2022 as Air Canada no longer qualified under the available programs (gross subsidy of $160 million in the second quarter of 2021; $158 million net of costs; gross subsidy of $326 million for the six months of 2021; $321 million net of costs).

Workforce Reduction Provisions

As a result of the impact of the COVID-19 pandemic and to mitigate the number of employees who were on layoff status, during the second quarter of 2021, Air Canada offered early retirement incentive programs to its unionized workforce. These programs provided for pension improvements which were payable from the defined benefit pension plan for eligible employees, and as such did not impact Air Canada's liquidity position. Termination benefits and a curtailment loss of $157 million were recorded as a special item during the second quarter of 2021.

Benefit Plan Amendments

In April 2021, Air Canada received the decision of the arbitrator determining the cap on pensionable earnings recognized in the defined benefit pension plan for IAMAW-represented technical employees. The decision resulted in an increase to the maximum pensionable earnings, effective from 2021. Air Canada recorded a one-time pension past service cost of $68 million as a special item in the second quarter of 2021 as a result of this plan amendment. The period of retroactivity was resolved in the latter half of 2021, with retroactivity to 2019 for employees that so elected with an additional $14 million recorded in 2021 as a special item. This amendment did not impact the Corporation's liquidity position as it is funded out of the surplus in the domestic registered pension plans.

Other

Termination of the Transat Arrangement Agreement

In April 2021, Air Canada announced that the arrangement agreement for the proposed acquisition by Air Canada of Transat A.T. Inc ("Transat") was terminated, including the payment of a $12.5 million termination fee to Transat. The termination fee was recorded as a Special item during the first quarter of 2021.

Amendments to Capacity Purchase Agreements

In March 2021, Air Canada announced an agreement to amend the capacity purchase agreement ("Jazz CPA") with Jazz, under which Jazz currently operates regional flights under the Air Canada Express brand. Through the revised agreement, Air Canada transferred the operation of its Embraer E175 fleet to Jazz from Sky Regional and Jazz became the sole operator of flights under the Air Canada Express brand. The capacity purchase agreement with Sky Regional was terminated. Air Canada recorded a net expense of $2 million, related to the CPA revisions and consolidation of regional flying.

Other operating expenses

In the second quarter of 2022, other operating expenses of $355 million increased $174 million or 96% from the same period in 2021. The increase was mainly due to an increased level of flying year-over-year.

The following table provides a breakdown of other expenses for the periods indicated.

	Second Quarter				First Six Months			
(Canadian dollars in millions)	**2022**	**2021**	**$ Change**	**% Change**	**2022**	**2021**	**$ Change**	**% Change**
Terminal handling	$ 68	$ 32	$ 36	113	$ 129	$ 62	$ 67	108
Crew cycle	51	16	35	219	90	28	62	221
Building rent and maintenance	45	31	14	45	86	63	23	37
Miscellaneous fees and services	40	37	3	8	88	68	20	29
Remaining other expenses	151	65	86	132	279	126	153	121
Total other expenses	**$ 355**	**$ 181**	**$ 174**	**96**	**$ 672**	**$ 347**	**$ 325**	**94**

Non-Operating Expense

In the second quarter of 2022, total non-operating expense was $99 million compared to $165 million in the second quarter of 2021. In the first six months of 2022, total non-operating expense was $363 million compared to $503 million in the same period of 2021.

For both the second quarter and the first six months of 2022, foreign exchange, interest expense, and gains on financial instruments were the most significant variances as compared to the same period in 2021.

Losses on foreign exchange amounted to $196 million in the second quarter of 2022 compared to losses of $5 million in the second quarter of 2021. The June 30, 2022 closing exchange rate was US$1=$1.2873 compared to US$1=$1.2505 at March 31, 2022. The losses of $337 million on long-term debt and lease liabilities were partially offset by gains of $177 million on foreign currency derivatives.

Losses on foreign exchange amounted to $97 million in the first six months of 2022 compared to gains of $62 million in the first six months of 2021. The June 30, 2022 closing exchange rate was US$1 = $1.2873 compared to US$1=$1.2637 at December 31, 2021. The losses of $204 million on long-term debt and lease liabilities were partially offset by gains of $138 million on foreign currency derivatives.

Interest expense of $216 million in the second quarter of 2022 increased $52 million from the second quarter of 2021 (interest expense of $425 million in the first six months of 2022 increased $84 million from the first six months of 2021). The increases were mainly due to higher levels of debt as a result of the financing transactions concluded during 2021.

In the second quarter of 2022, Air Canada recorded gains of $287 million on financial instruments recorded at fair value compared to losses of $5 million in the second quarter of 2021. Gains of $114 million in the first six months of 2022 compared to losses of $228 million in the first six months of 2021. The gains were primarily due to the fluctuation in the fair value of Air Canada's convertible notes cash conversion settlement option, which resulted in a $321 million gain in the second quarter of 2022 and a $196 million gain in the first six months of 2022.

6. FLEET

The tables below provide the number of aircraft in Air Canada's and Air Canada Rouge's operating fleet as at December 31, 2021 and as at June 30, 2022, as well as the planned fleet for the future periods indicated.

The tables below include aircraft that have been grounded in response to the COVID-19 pandemic. In the second quarter of 2022, Air Canada took delivery of two new Boeing 767 freighter aircraft which are expected to enter service in 2023; these aircraft are included in the table below.

AIR CANADA	Actual			Planned			
	Dec. 31, 2021	**First Six Months of 2022 Fleet Changes**	**Jun. 30, 2022**	**Remainder 2022 Fleet Changes**	**Dec. 31, 2022**	**2023 Fleet Changes**	**Dec. 31, 2023**
Wide-body aircraft							
Boeing 777-300ER	11	7	18	-	18	-	18
Boeing 777-300ER (cargo)	7	(7)	-	-	-	-	-
Boeing 777-200LR	6	-	6	-	6	-	6
Boeing 787-8	8	-	8	-	8	-	8
Boeing 787-9	29	-	29	-	29	2	31
Boeing 767-300 freighters	1	3	4	2	6	1	7
Airbus A330-300	12	4	16	-	16	-	16
Airbus A330-300 (cargo)	4	(4)	-	-	-	-	-
Total wide-body aircraft	78	3	81	2	83	3	86
Narrow-body aircraft							
Boeing 737 MAX 8	31	8	39	1	40	-	40
Airbus A321	15	-	15	-	15	-	15
Airbus A320	18	-	18	(2)	16	-	16
Airbus A319	6	-	6	(3)	3	-	3
Airbus A220-300	27	3	30	3	33	-	33
Total narrow-body aircraft	97	11	108	(1)	107	-	107
Total Mainline	**175**	**14**	**189**	**1**	**190**	**3**	**193**

AIR CANADA rouge	Actual			Planned			
	Dec. 31, 2021	First Six Months of 2022 Fleet Changes	Jun. 30, 2022	Remainder 2022 Fleet Changes	Dec. 31, 2022	2023 Fleet Changes	Dec. 31, 2023
Narrow-body aircraft							
Airbus A321	14	-	14	-	14	-	14
Airbus A320	5	-	5	-	5	-	5
Airbus A319	20	-	20	-	20	-	20
Total Air Canada Rouge	**39**	**-**	**39**	**-**	**39**	**-**	**39**

Total Mainline & Rouge	**214**	**14**	**228**	**1**	**229**	**3**	**232**

Air Canada Express

The table below provides the number of aircraft operated as at December 31, 2021 and as at June 30, 2022, on behalf of Air Canada, by its regional carrier operating flights under the Air Canada Express banner pursuant to a capacity purchase agreement with Air Canada. The table also provides the planned fleet for the future periods indicated.

AIR CANADA EXPRESS	Actual			Planned			
	Dec. 31, 2021	First Six Months of 2022 Fleet Changes	Jun. 30, 2022	Remainder 2022 Fleet Changes	Dec. 31, 2022	2023 Fleet Changes	Dec. 31, 2023
Embraer 175	25	-	25	-	25	-	25
Mitsubishi CRJ-200	15	-	15	-	15	-	15
Mitsubishi CRJ-900	35	-	35	-	35	-	35
De Havilland Dash 8-300	9	(9)	-	-	-	-	-
De Havilland Dash 8-400	39	-	39	-	39	(3)	36
Total Air Canada Express	**123**	**(9)**	**114**	**-**	**114**	**(3)**	**111**

7. FINANCIAL AND CAPITAL MANAGEMENT

7.1 LIQUIDITY

Impact of the COVID-19 Pandemic

Since March 2020, Air Canada and the rest of the global airline industry have faced significantly lower traffic than in 2019, and a corresponding decline in revenue and cash flows, as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world including in Canada. Conditions have improved and travel restrictions have been lifted in many countries, but the wide-ranging impact of the COVID-19 pandemic and certain other factors have impeded Air Canada's and the global airline industry's restart efforts. It has also affected the ability of some of its participants, on which Air Canada's operations are dependent, to support the surge in traffic. This has led to flight delays and cancellations, and other operational disruptions and challenges.

One of Air Canada's key objectives is to return to sustainable profitability and to sustain and improve cash flows from operations to manage its liquidity needs. Air Canada has recently seen a progressive improvement in cash flows from operating activities. Considering the uncertainty brought about by the COVID-19 pandemic, the recent challenges faced by the global airline industry to meet the surge in traffic, the volatility of aircraft fuel prices, and geopolitical, economic, and other factors, the timing and extent of the return to pre-pandemic traffic levels remains difficult to predict.

Liquidity Risk Management

Air Canada manages its liquidity needs through a variety of strategies, including by seeking to sustain and improve cash from operations and free cash flow, sourcing committed financing for new and existing aircraft, and through other financing activities.

Liquidity needs are primarily related to meeting obligations associated with financial liabilities, capital commitments, ongoing operations, contractual and other obligations, which are further discussed in sections 7.6 "Capital Expenditures and Related Financing Arrangements", 7.7 "Pension Funding Obligations", and 7.8 "Contractual Obligations" of this MD&A. Air Canada monitors and manages liquidity risk by preparing rolling cash flow forecasts for a minimum period of at least twelve months after each reporting period, including under various scenarios and assumptions, monitoring the condition and value of assets available to be used as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements. At June 30, 2022 unrestricted liquidity was $10,508 million comprised of cash and cash equivalents, short-term and long-term investments of $9,536 million, and $972 million available under undrawn credit facilities.

Air Canada estimates that it requires a minimum unrestricted liquidity balance of $5,000 million to support ongoing business operations, updated from the $2,400 million amount as reported at December 31, 2021. This minimum cash estimate considers Air Canada's various financial covenants, provides adequate coverage for advance ticket sales, and supports Air Canada's liquidity needs, as described above. The increase in the minimum liquidity balance from the amount reported at December 31, 2021 reflects the increasing scale of operations as Air Canada continues to rebuild the airline and also includes a larger buffer to manage cost risk and unplanned disruptions. Minimum unrestricted liquidity includes funds available under credit facilities.

7.2 FINANCIAL POSITION

The table below provides a condensed consolidated statement of financial position of Air Canada as at June 30, 2022, and as at December 31, 2021.

(Canadian dollars in millions)	June 30, 2022	December 31, 2021	$ Change
Assets			
Cash, cash equivalents and short-term investments	$ 8,689	$ 8,802	$ (113)
Other current assets	1,881	1,251	630
Current assets	**$ 10,570**	**$ 10,053**	**$ 517**
Investments, deposits, and other assets	1,105	858	247
Property and equipment	11,977	11,740	237
Pension assets	2,324	3,571	(1,247)
Deferred income tax	47	39	8
Intangible assets	1,068	1,080	(12)
Goodwill	3,273	3,273	-
Total assets	**$ 30,364**	**$ 30,614**	**$ (250)**
Liabilities			
Current liabilities	$ 9,201	$ 6,924	$ 2,277
Long-term debt and lease liabilities	15,400	15,511	(111)
Aeroplan and other deferred revenues	3,518	3,656	(138)
Pension and other benefit liabilities	1,863	2,588	(725)
Maintenance provisions	1,178	1,032	146
Other long-term liabilities	589	821	(232)
Deferred income tax	73	73	-
Total liabilities	**$ 31,822**	**$ 30,605**	**$ 1,217**
Total shareholders' equity (deficiency)	**$ (1,458)**	**$ 9**	**$ (1,467)**
Total liabilities and shareholders' equity (deficiency)	**$ 30,364**	**$ 30,614**	**$ (250)**

Movements in current assets and current liabilities are described in section 7.4 "Working Capital" of this MD&A. Long-term debt and lease liabilities are discussed in sections 7.3 "Net Debt" and 7.5 "Cash Flow Movements" of this MD&A.

At June 30, 2022, net long-term benefit assets of $461 million (comprising pension assets of $2,324 million net of pension and other benefit liabilities of $1,863 million) decreased $522 million from December 31, 2021. This decrease was mainly due to a net actuarial loss on remeasurements of employee liabilities of $293 million ($118 million, net of tax) recorded on Air Canada's consolidated statement of comprehensive income, as well as pension and other employee benefits expense recorded during the year. The actuarial loss reflects the limit on the amount of pension assets that can be recognized under the accounting rules. While the actuarial gain on the 214-basis point increase in discount rate used to value the liabilities offset a lower return on plan assets, the net asset that could be recognized was capped to the amount of surplus available to reduce future funding requirements.

The long-term portion of the Aeroplan and other deferred revenue liability decreased $138 million from December 31, 2021 primarily due to Aeroplan Point redemptions exceeding the sale of points to program partners. The decrease to Other long-term liabilities included a $196 million decrease in the fair value liability of the embedded derivative on Air Canada's convertible notes.

7.3 NET DEBT

The table below reflects Air Canada's net debt balances as at June 30, 2022, and as at December 31, 2021.

(Canadian dollars in millions)	**June 30, 2022**	**December 31, 2021**	**$ Change**
Total long-term debt and lease liabilities	$ 15,400	$ 15,511	$ (111)
Current portion of long-term debt and lease liabilities	1,164	1,012	152
Total long-term debt and lease liabilities (including current portion)	**16,564**	**16,523**	**41**
Less cash, cash equivalents and short and long-term investments	(9,536)	(9,403)	(133)
Net debt (1)	**$ 7,028**	**$ 7,120**	**$ (92)**

(1) Net debt is a capital management measure and a key component of the capital managed by Air Canada and provides management with a measure of its net indebtedness. For additional information on net debt, refer to section 16 "Non-GAAP Financial Measures" of this MD&A.

As at June 30, 2022, net debt of $7,028 million decreased $92 million from December 31, 2021, reflecting the impact of higher cash balances and debt repayments made during the period. The unfavorable impact of a weaker Canadian dollar at June 30, 2022 compared to December 31, 2021, increased foreign currency denominated debt (mainly U.S. dollars) by $205 million.

7.4 WORKING CAPITAL

The table below provides information on Air Canada's working capital balances as at June 30, 2022 and as at December 31, 2021.

(Canadian dollars in millions)	June 30, 2022	December 31, 2021	$ Change
Cash, cash equivalents and short-term investments	$ 8,689	$ 8,802	$ (113)
Accounts receivable	1,072	691	381
Other current assets	809	560	249
Total current assets	**$ 10,570**	**$ 10,053**	**$ 517**
Accounts payable and accrued liabilities	2,459	2,603	(144)
Advance ticket sales	4,618	2,326	2,292
Aeroplan and other deferred revenues	960	983	(23)
Current portion of long-term debt and lease liabilities	1,164	1,012	152
Total current liabilities	**$ 9,201**	**$ 6,924**	**$ 2,277**
Net working capital	**$ 1,369**	**$ 3,129**	**$ (1,760)**

Net working capital of $1,369 million as at June 30, 2022 decreased $1,760 million from December 31, 2021. This decrease was due to a combination of the operating loss, net cash outflows relating to capital expenditures, and debt repayments in the first half of 2022. The increases in accounts receivable, other current assets and advance ticket sales are mainly driven by the passenger sales demand which is supported with the increased capacity.

7.5 CASH FLOW MOVEMENTS

The table below provides the cash flow movements for Air Canada for the periods indicated.

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2022**	**2021**	**$ Change**	**2022**	**2021**	**$ Change**
Net cash flows from (used in) operating activities	**$ 1,077**	**$ (1,377)**	**$ 2,454**	**$ 1,412**	**$ (2,265)**	**$ 3,677**
Proceeds from borrowings	123	1,139	(1,016)	161	1,267	(1,106)
Reduction of long-term debt and lease liabilities	(270)	(877)	607	(501)	(1,281)	780
Issue of shares	1	480	(479)	2	554	(552)
Financing fees	(1)	(4)	3	(1)	(7)	6
Net cash flows from (used in) financing activities	**$ (147)**	**$ 738**	**$ (885)**	**$ (339)**	**$ 533**	**$ (872)**
Investments, short-term and long-term	(698)	356	(1,054)	(1,670)	1,350	(3,020)
Additions to property, equipment, and intangible assets	(636)	(266)	(370)	(912)	(546)	(366)
Proceeds from sale of assets	2	6	(4)	5	11	(6)
Proceeds from sale and leaseback of assets	-	5	(5)	-	11	(11)
Other	9	(11)	20	(2)	(5)	3
Net cash flows from (used in) investing activities	**$ (1,323)**	**$ 90**	**$ (1,413)**	**$ (2,579)**	**$ 821**	**$ (3,400)**
Effect of exchange rate changes on cash and cash equivalents	**$ 7**	**$ (19)**	**$ 26**	**$ 18**	**$ (37)**	**$ 55**
Decrease in cash and cash equivalents	**$ (386)**	**$ (568)**	**$ 182**	**$ (1,488)**	**$ (948)**	**$ (540)**

Net Cash Flows from (used in) Operating Activities

In the second quarter of 2022, net cash flows from operating activities of $1,077 million improved by $2,454 from the same quarter in 2021. In the first six months of 2022, net cash flows from operating activities of $1,412 million improved by $3,677 million from the same period in 2021. The improvements were due to strong advance ticket sales and a significant increase in passengers carried when compared to the same periods in 2021. Additionally, the second quarter of 2021 included cash outflows from operating activities of $997 million related to the refund of non-refundable fares.

Net Cash Flows from (used in) Financing Activities

In the second quarter of 2022, net cash flows used in financing activities of $147 million (net cash flows used in financing activities of $339 million in the first six months of 2022) relate to debt repayments, partially offset by new borrowings for Airbus A220 aircraft deliveries.

Net Cash Flows from (used in) Investing Activities

Net movements between cash and short and long-term investments amounted to $(698) million and $(1,670) million during the second quarter of 2022 and the first six months of 2022, respectively. Additions to property, equipment and intangible assets for the six months of 2022 of $912 million increased $366 million from the same period in 2021. These additions relate mainly to aircraft acquisitions and related pre-delivery payments, capitalized maintenance and technology projects.

Refer to sections 7.2 "Financial Position", 7.3 "Net Debt", and 7.4 "Working Capital" of this MD&A for additional information.

Free Cash Flow

The table below provides the calculation of free cash flow(1) for Air Canada for the periods indicated.

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2022**	**2021**	**$ Change**	**2022**	**2021**	**$ Change**
Net cash flows from (used in) operating activities	**$ 1,077**	**$ (1,377)**	**$ 2,454**	**$ 1,412**	**$ (2,265)**	**$ 3,677**
Additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions	(636)	(261)	(375)	(912)	(535)	(377)
Free cash flow (1)	**$ 441**	**$ (1,638)**	**$ 2,079**	**$ 500**	**$ (2,800)**	**$ 3,300**

(1) *Free cash flow is a non-GAAP financial measure used by Air Canada as an indicator of the financial strength and performance of its business, indicating how much cash it can generate from operations after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment, and intangible assets, net of proceeds from sale and leaseback transactions. Such measure is not a recognized measure for financial statement presentation under GAAP, does not have a standardized meaning, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.*

Free cash flow of $441 million in the second quarter of 2022 and of $500 million in the first six months of 2022 improved $2,079 million and $3,300 million, respectively, from the same periods in 2021, reflecting higher net cash flows from operations as a result of an improved operating environment and strong advance ticket sales.

7.6 CAPITAL EXPENDITURES AND RELATED FINANCING ARRANGEMENTS

Airbus A321XLR Aircraft

Air Canada is acquiring 30 extra-long range (XLR) versions of the Airbus A321neo aircraft (Airbus A321XLR). Deliveries are expected to begin in 2024 with the final aircraft to arrive in 2027, however, the first aircraft deliveries are expected to be delayed by at least six months. Of the 30 total aircraft, 20 aircraft will be leased and 10 are being acquired under a purchase agreement with Airbus S.A.S. that includes purchase rights to acquire up to an additional 15 aircraft between 2027 and 2030.

Airbus A220-300 Aircraft

Air Canada's agreement with Airbus Canada for the purchase of Airbus A220-300 aircraft provides for:

- Firm orders for 45 Airbus A220-300 aircraft
- Purchase options for 30 additional Airbus A220-300 aircraft

In January 2022, Air Canada elected to proceed with the purchase of an additional 10 Airbus A220 aircraft, in addition to the two Airbus A220 aircraft that were added in 2021. These 12 aircraft are those that Air Canada had stated, in November 2020, it would no longer be purchasing. Planned deliveries for the 12 aircraft are: six in 2024, and six in 2025.

In March 2021, Air Canada concluded a committed secured facility totalling US$475 million to finance the purchase of the next 15 Airbus A220 aircraft scheduled for delivery in 2021 and 2022. Financing remains available for an additional three Airbus A220 aircraft under this facility.

As at June 30, 2022, 30 Airbus A220-300 aircraft had been delivered.

Boeing 737 MAX

Air Canada's agreement with Boeing for the purchase of Boeing 737 MAX aircraft provides for:

- Firm orders for 40 Boeing 737 MAX 8 aircraft
- Purchase options for 10 Boeing 737 MAX aircraft

At June 30, 2022, 39 Boeing 737 MAX 8 aircraft had been delivered. The remaining one on firm order is expected to be delivered in the third quarter of 2022.

Boeing 787-9 Aircraft

Air Canada exercised options for the purchase of three Boeing 787-9 aircraft which are scheduled to be delivered in 2023 and in 2024. Air Canada has no additional purchase options for Boeing 787 aircraft.

Boeing 767 Freighter Aircraft

Air Canada finalized an agreement for the purchase of two new Boeing 767 freighter aircraft which were delivered in the second quarter of 2022 and are expected to enter service in 2023.

Boeing 777 Freighter Aircraft

Air Canada finalized an agreement for the purchase of two new Boeing 777 freighter aircraft with deliveries expected in 2024.

Capital Commitments

As outlined in the table below, the estimated aggregate cost of all aircraft expected to be delivered and other capital purchase commitments at June 30, 2022 amounted to $5,803 million.

(Canadian dollars in millions)	Remainder of 2022	2023	2024	2025	2026	Thereafter	Total
Committed expenditures	$ 632	$ 797	$ 874	$ 626	$ 629	$ 2,245	$ 5,803
Projected planned but uncommitted expenditures	81	323	298	493	364	not available	Not available
Projected planned but uncommitted capitalized maintenance (1)	198	384	447	270	350	not available	Not available
Total projected expenditures (2)	**$ 911**	**$ 1,504**	**$ 1,619**	**$ 1,389**	**$ 1,343**	**$ 2,245**	**Not available**

(1) Future capitalized maintenance amounts for 2025 and beyond are not yet determinable, however estimates of $270 million and $350 million have been made for 2025 and 2026, respectively.

(2) U.S. dollar amounts are converted using the June 30, 2022 closing exchange rate of US$1=C$1.2873. The estimated aggregate cost of aircraft is based on delivery prices that include estimated escalation and, where applicable, deferred price delivery payment interest calculated based on the 90-day U.S. LIBOR rate at June 30, 2022.

7.7 PENSION FUNDING OBLIGATIONS

As at January 1, 2022, the aggregate solvency surplus in Air Canada's domestic registered pension plans was $4.8 billion.

Air Canada's pension funding obligations are discussed in section 9.7 "Pension Funding Obligations" of Air Canada's 2021 MD&A. There have been no material changes to Air Canada's pension funding obligations from what was disclosed at that time.

7.8 CONTRACTUAL OBLIGATIONS

The table below provides Air Canada's projected contractual obligations as at June 30, 2022, including those relating to interest and principal repayment obligations on Air Canada's long-term debt and lease liabilities and committed capital expenditures.

(Canadian dollars in millions)	Remainder of 2022 (2)	2023	2024	2025	2026	Thereafter	Total
Principal							
Long-term debt (1)	$ 273	$ 682	$ 503	$ 1,826	$ 2,426	$ 8,398	$ 14,108
Lease liabilities	262	513	475	448	314	1,077	3,089
Total principal obligations	**535**	**1,195**	**978**	**2,274**	**2,740**	**9,475**	**17,197**
Interest							
Long-term debt	$ 288	$ 553	$ 529	$ 500	$ 417	$ 710	$ 2,997
Lease liabilities	78	135	109	84	65	311	782
Total interest obligations	**$ 366**	**$ 688**	**$ 638**	**$ 584**	**$ 482**	**$ 1,021**	**$ 3,779**
Total long-term debt and lease liabilities	**$ 901**	**$ 1,883**	**$ 1,616**	**$ 2,858**	**$ 3,222**	**$ 10,496**	**$ 20,976**
Committed capital expenditures	**$ 632**	**$ 797**	**$ 874**	**$ 626**	**$ 629**	**$ 2,245**	**$ 5,803**
Total contractual obligations (2)	**$ 1,533**	**$ 2,680**	**$ 2,490**	**$ 3,484**	**$ 3,851**	**$ 12,741**	**$ 26,779**

(1) Assumes the principal balance of the convertible notes, $962 million (US$748 million), remains unconverted and includes estimated interest payable until maturity in 2025. The full principal balance of $1,273 million for the unsecured credit facility in connection with the Government of Canada financing to support customer refunds is included.

(2) Total contractual obligations exclude commitments for goods and services required in the ordinary course of business. Also excluded are long-term liabilities other than long-term debt and lease liabilities due to reasons of uncertainty of timing of cash flows and items that are non-cash in nature.

7.9 SHARE INFORMATION

The issued and outstanding shares of Air Canada, along with shares potentially issuable, as of the dates indicated below, are as follows:

	June 30, 2022	December 31, 2021
Issued and outstanding shares		
Class A variable voting shares	63,808,709	82,897,507
Class B voting shares	294,159,444	274,944,350
Total issued and outstanding shares	**357,968,153**	**357,841,857**
Class A variable voting and Class B voting shares potentially issuable		
Convertible notes	48,687,441	48,687,441
Warrants	-	7,288,282
Stock options	5,470,390	4,330,993
Total shares potentially issuable	**54,157,831**	**60,306,716**
Total outstanding and potentially issuable shares	**412,125,984**	**418,148,573**

Warrants

As described in section 9.9 "Share Information" of Air Canada's 2021 MD&A, Air Canada exercised its call right to purchase and cancel the 7,288,282 vested warrants at fair market value of $82 million, with settlement completed in January 2022.

8. QUARTERLY FINANCIAL DATA

The table below summarizes quarterly financial results for Air Canada for the last eight quarters.

(Canadian dollars in millions, except per share figures)	**2020**		**2021**				**2022**	
	Q3	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Operating revenues	$ 757	$ 827	$ 729	$ 837	$ 2,103	$ 2,731	$ 2,573	$ 3,981
Operating expenses	1,542	1,830	1,778	1,970	2,467	3,234	3,123	4,234
Operating loss	**(785)**	**(1,003)**	**(1,049)**	**(1,133)**	**(364)**	**(503)**	**(550)**	**(253)**
Non-operating income (expense)	**(36)**	**(272)**	**(338)**	**(165)**	**(315)**	**(114)**	**(264)**	**(99)**
Loss before income taxes	**(821)**	**(1,275)**	**(1,387)**	**(1,298)**	**(679)**	**(617)**	**(814)**	**(352)**
Income tax recovery (expense)	136	114	83	133	39	124	(160)	(34)
Net loss	**$ (685)**	**$ (1,161)**	**$ (1,304)**	**$ (1,165)**	**$ (640)**	**$ (493)**	**$ (974)**	**$ (386)**
Diluted loss per share	**$ (2.31)**	**$ (3.91)**	**$ (3.90)**	**$ (3.31)**	**$ (1.79)**	**$ (1.38)**	**$ (2.72)**	**$ (1.60)**
Adjusted pre-tax loss(1)	**$ (1,141)**	**$ (1,326)**	**$ (1,335)**	**$ (1,210)**	**$ (649)**	**$ (574)**	**$ (740)**	**$ (447)**

(1) Adjusted pre-tax loss is a non-GAAP financial measure. For additional information, refer to section 16 "Non-GAAP Financial Measures" of this MD&A.

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Air Canada's financial instruments and risk management practices are summarized in section 12 "Financial Instruments and Risk Management" of Air Canada's 2021 MD&A. There have been no material changes to Air Canada's financial instruments and risk management practices from what was disclosed at that time. Additional information on Air Canada's risk management practices and financial instruments is provided in Note 9 of Air Canada's interim unaudited condensed consolidated financial statements for the second quarter of 2022.

10. ACCOUNTING POLICIES

Air Canada's accounting policies are summarized in Note 2 of Air Canada's audited consolidated financial statements and notes for 2021. There have been no material changes to Air Canada's accounting policies from what was disclosed at that time. Additional information on Air Canada's accounting policies is provided in Note 2 of Air Canada's interim unaudited condensed consolidated financial statements for the second quarter of 2022.

11. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Air Canada's critical accounting estimates and judgments are summarized in section 14 "Critical Accounting Estimates and Judgments" of Air Canada's 2021 MD&A. There have been no material changes to critical accounting estimates and judgments from what was disclosed at that time.

12. OFF-BALANCE SHEET ARRANGEMENTS

Air Canada's off-balance sheet arrangements are summarized in section 15 "Off-Balance Sheet Arrangements" of Air Canada's 2021 MD&A. There have been no material changes to Air Canada's off-balance sheet arrangements from what was disclosed at that time.

13. RELATED PARTY TRANSACTIONS

At June 30, 2022, Air Canada had no transactions with related parties as defined in the CPA Handbook, except those pertaining to transactions with key management personnel in the ordinary course of their employment or directorship agreements.

14. RISK FACTORS

For a description of risk factors associated with Air Canada and its business, refer to section 18 "Risk Factors" of Air Canada's 2021 MD&A. There have been no material changes to Air Canada's risk factors from what was disclosed at that time, except for the following.

Since March 2020, Air Canada and the rest of the global airline industry have faced significantly lower traffic than in 2019, and a corresponding decline in revenue and cash flows, as a result of the COVID-19 pandemic and the travel restrictions imposed in many countries around the world including in Canada. Conditions have improved and travel restrictions have been lifted in many countries, but the wide-ranging impact of the COVID-19 pandemic and certain other factors have impeded Air Canada's and the global airline industry's restart efforts. It has also affected the ability of some of its participants, on which Air Canada's operations are dependent, to support the surge in traffic. This has led to flight delays and cancellations, and other operational disruptions and challenges. Air Canada's costs and revenues may be adversely impacted as a result of these disruptions and challenges. Air Canada cannot predict the impact or timing for when they may be overcome or the timing and extent of the return to pre-pandemic traffic levels, including for business and international travel. The impact of the COVID-19 pandemic continues to evolve, amplifying or adding new risks, including economic risks, any of which could materially and adversely affect Air Canada's business, results from operations, financial condition.

15. CONTROLS AND PROCEDURES

Air Canada's controls and procedures are summarized in section 17 "Enterprise Risk Management and Governance" of Air Canada's 2021 MD&A. There have been no material changes to Air Canada's controls and procedures from what was disclosed at that time.

16. NON-GAAP FINANCIAL MEASURES

Below is a description of certain non-GAAP financial measures and ratios used by Air Canada to provide readers with additional information on its financial and operating performance. Such measures are not recognized measures for financial statement presentation under GAAP, do not have standardized meanings, may not be comparable to similar measures presented by other entities and should not be considered a substitute for or superior to GAAP results.

EBITDA

EBITDA (earnings before interest, taxes, depreciation and amortization) is commonly used in the airline industry and is used by Air Canada as a means to view operating results before interest, taxes, depreciation and amortization as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets. Air Canada excludes special items from EBITDA as these items may distort the analysis of certain business trends and render comparative analysis across periods or to other airlines less meaningful.

EBITDA Margin

EBITDA margin (EBITDA as a percentage of operating revenue) is commonly used in the airline industry and is used by Air Canada as a means to measure the operating margin before interest, taxes, depreciation and amortization as these costs can vary significantly among airlines due to differences in the way airlines finance their aircraft and other assets.

EBITDA and EBITDA margin are reconciled to GAAP operating income (loss) as follows:

	Second Quarter			First Six Months		
(Canadian dollars in millions, except where indicated)	**2022**	**2021**	**Change**	**2022**	**2021**	**Change**
Operating loss – GAAP	**$ (253)**	**$ (1,133)**	**$ 880**	**$ (803)**	**$ (2,182)**	**$ 1,379**
Add back:						
Depreciation and amortization	407	404	3	810	817	(7)
EBITDA (including special items)	**$ 154**	**$ (729)**	**$ 883**	**$ 7**	**$ (1,365)**	**$ 1,372**
Remove:						
Special items	-	73	(73)	4	(54)	58
EBITDA (excluding special items)	**$ 154**	**$ (656)**	**$ 810**	**$ 11**	**$ (1,419)**	**$ 1,430**
Operating margin (%)	**(6)**	**(135)**	**129 pp**	**(12)**	**(139)**	**127 pp**
EBITDA margin (%)	**4**	**(78)**	**82 pp**	**0**	**(91)**	**91 pp**

Adjusted CASM

Air Canada uses adjusted CASM to assess the operating and cost performance of its ongoing airline business without the effects of aircraft fuel expense, the cost of ground packages at Air Canada Vacations, freighter costs, and special items as these items may distort the analysis of certain business trends and render comparative analysis across periods or to other airlines less meaningful.

In calculating adjusted CASM, aircraft fuel expense is excluded from operating expense results as it fluctuates widely depending on many factors, including international market conditions, geopolitical events, jet fuel refining costs and Canada/U.S. currency exchange rates. Air Canada also incurs expenses related to ground packages at Air Canada Vacations which some airlines, without comparable tour operator businesses, may not incur. In addition, these costs do not generate ASMs and therefore excluding these costs from operating expense results provides for a more meaningful comparison across periods when such costs may vary.

Air Canada also incurs expenses related to the operation of freighter aircraft which some airlines, without comparable cargo businesses, may not incur. Air Canada introduced one Boeing 767 dedicated freighter to its fleet in December 2021 and added a second Boeing 767 freighter in April 2022. In the second quarter of 2022, Air Canada took delivery of two new Boeing 767 freighter aircraft, which are expected to enter service in 2023. Air Canada expects to have a fleet of seven Boeing 767 dedicated freighters by the end of 2023. Prior to 2021, Air Canada did not incur any costs related to the operation of dedicated freighter aircraft. These costs do not generate ASMs and therefore excluding these costs from operating expense results provides for a more meaningful comparison across periods when such costs may vary.

Excluding aircraft fuel expense, the cost of ground packages at Air Canada Vacations, dedicated freighter expenses and special items from operating expenses generally allows for a more meaningful analysis of Air Canada's operating expense performance and a more meaningful comparison to that of other airlines.

Adjusted CASM is reconciled to GAAP operating expense as follows:

(Canadian dollars in millions, except where indicated)	Second Quarter			First Six Months		
	2022	2021	Change	2022	2021	Change
Operating expense – GAAP	**$ 4,234**	**$ 1,970**	**$ 2,264**	**$ 7,357**	**$ 3,748**	**$ 3,609**
Adjusted for:						
Aircraft fuel	(1,450)	(239)	(1,211)	(2,200)	(439)	(1,761)
Ground package costs	(102)	(1)	(101)	(231)	(6)	(225)
Special items	-	(73)	73	(4)	54	(58)
Freighter costs	(22)	-	(22)	(33)	-	(33)
Operating expense, adjusted for the above-noted items	**$ 2,660**	**$ 1,657**	**$ 1,003**	**4,889**	**3,357**	**1,532**
ASMs (millions)	**20,331**	**4,000**	**408.3%**	**34,628**	**8,211**	**321.7%**
Adjusted CASM (cents)	**¢ 13.09**	**¢ 41.45**	**¢ (28.36)**	**¢ 14.12**	**¢ 40.89**	**¢ (26.77)**

Adjusted Pre-tax Income (Loss)

Adjusted pre-tax income (loss) is used by Air Canada to assess the overall pre-tax financial performance of its business without the effects of foreign exchange gains or losses, net interest relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on disposal of assets, gains or losses on debt settlements and modifications, and special items as these items may distort the analysis of certain business trends and render comparative analysis across periods or to other airlines less meaningful.

Adjusted pre-tax income (loss) is reconciled to GAAP income (loss) before income taxes as follows:

	Second Quarter			First Six Months		
(Canadian dollars in millions)	**2022**	**2021**	**$ Change**	**2022**	**2021**	**$ Change**
Loss before income taxes – GAAP	**$ (352)**	**$ (1,298)**	**$ 946**	**$ (1,166)**	**$ (2,685)**	**$ 1,519**
Adjusted for:						
Special items	-	73	(73)	4	(54)	58
Foreign exchange (gain) loss	196	5	191	97	(62)	159
Net interest relating to employee benefits	(4)	5	(9)	(8)	9	(17)
(Gain) loss on financial instruments recorded at fair value	(287)	5	(292)	(114)	228	(342)
Loss on debt settlements and modifications	-	-	-	-	19	(19)
Adjusted pre-tax loss	**$ (447)**	**$ (1,210)**	**$ 763**	**$ (1,187)**	**$ (2,545)**	**$ 1,358**

Free Cash Flow

Air Canada uses free cash flow as an indicator of the financial strength and performance of its business, indicating the amount of cash Air Canada can generate from operations and after capital expenditures. Free cash flow is calculated as net cash flows from operating activities minus additions to property, equipment, and intangible assets, and is net of proceeds from sale and leaseback transactions. Refer to section 7.5 "Cash Flow Movements" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

Net Debt

Net debt is a capital management measure and a key component of the capital managed by Air Canada and provides management with a measure of its net indebtedness. Refer to section 7.3 "Net Debt" of this MD&A for a reconciliation of this capital management measure to the nearest measure under GAAP.

17. GLOSSARY

Adjusted CASM – Refers to operating expense per ASM adjusted to remove the effects of aircraft fuel expense, ground packages costs at Air Canada Vacations, special items, and freighter costs. Adjusted CASM is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Adjusted pre-tax income (loss) – Refers to the consolidated income (loss) of Air Canada before income taxes and adjusted to remove the effects of foreign exchange gains or losses, net interest relating to employee benefits, gains or losses on financial instruments recorded at fair value, gains or losses on sale and leaseback of assets, gains or losses on debt settlements and modifications, gains or losses on disposal of assets, and special items. Adjusted pre-tax income (loss) is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Aeroplan – Refers to Aeroplan Inc.

Atlantic – In reference to passenger and cargo revenues, means revenues from flights that cross the Atlantic Ocean with origins and destinations principally in Europe, India, the Middle East and North Africa.

Available seat miles or ASMs – Refers to a measure of passenger capacity calculated by multiplying the total number of seats available for passengers by the miles flown.

Average stage length – Refers to the average mile per departure seat and is calculated by dividing total ASMs by total seats dispatched.

CASM – Refers to operating expense per ASM.

Domestic - In reference to passenger and cargo revenues, means revenues from flights within Canada.

EBITDA – Refers to earnings before interest, taxes, depreciation and amortization. EBITDA is a non-GAAP financial measure. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information. Air Canada excludes special items from EBITDA.

EBITDA margin – Refers to EBITDA as a percentage of operating revenue. Refer to section 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Free cash flow – Refers to net cash flows from operating activities minus additions to property, equipment, and intangible assets, and is net of proceeds from sale and leaseback transactions. Free cash flow is a non-GAAP financial measure. Refer to sections 7.5 "Cash Flow Movements" and 16 "Non-GAAP Financial Measures" of this MD&A for additional information.

Jazz – Refers to Jazz Aviation LP.

Jazz CPA – Refers to the capacity purchase agreement between Air Canada and Jazz.

Net debt – Refers to total long-term debt liabilities (including current portion) less cash, cash equivalents. and short- and long-term investment. Refer to section 7.3 "Net Debt" of this MD&A for a reconciliation of this non-GAAP financial measure to the nearest measure under GAAP.

Other - In reference to passenger and cargo revenues, means revenues from flights with origins and destinations principally in Central and South America, the Caribbean and Mexico.

Pacific - In reference to passenger and cargo revenues, means revenues from flights that cross the Pacific Ocean with origins and destinations principally in Asia and Australia.

Passenger load factor – Refers to a measure of passenger capacity utilization derived by expressing Revenue Passenger Miles as a percentage of Available Seat Miles.

Passenger revenue per available seat mile or PRASM – Refers to average passenger revenue per available seat mile.

Percentage point (pp) – Refers to a measure for the arithmetic difference of two percentages.

Revenue passenger carried – Refers to the International Air Transport Association's (IATA) definition of passenger carried whereby passengers are counted on a flight number basis rather than by journey/itinerary or by leg.

Revenue passenger miles or RPMs – Refers to a measure of passenger traffic calculated by multiplying the total number of revenue passengers carried by the miles they are carried.

Seats dispatched – Refers to the number of seats on non-stop flights. A non-stop flight refers to a single takeoff and landing.

Special items – Refers to those items that, in management's view, are to be separately disclosed by virtue of their significance to the financial statements, to enable a fuller understanding of the Air Canada's financial performance.

Yield – Refers to average passenger revenue per RPM.